No. 88-148

FILED
JUL 26 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

SOUTHERN NATURAL GAS COMPANY,
Petitioner,

v.

JOSEPH F. FRITZ, G. B. "BOOTS" SMITH CORPORATION, CHALLENGER DEEP WELL SERVICES, INC., H. LANIER B. FOOTE and EXXON CORPORATION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MISSISSIPPI

JOHN M. GROWER
(counsel of record)
R. WILSON MONTJOY II
JOHN E. WADE, JR.
BRUNINI, GRANTHAM, GROWER & HEWES
1400 Trustmark Building
Post Office Drawer 119
Jackson, Mississippi 39205
(601) 948-3101

WILLIAM A. MAJOR, JR.
JOHN C. GRIFFIN
SOUTHERN NATURAL GAS COMPANY
Post Office Box 2563
Birmingham, Alabama 35202-2563
(205) 325-7410

Counsel for Petitioner

July 26, 1988

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

In a case involving the legality of a gas purchase contract price under a regulation of the Federal Energy Regulatory Commission ("FERC"), did the Mississippi Supreme Court commit error in failing to defer to and conform its decision to a contrary FERC decision issued in essentially the same case and prior to the Mississippi court's final ruling?

PARTIES TO THE PROCEEDING BELOW

In the proceeding before the Mississippi Supreme Court the Appellant was Southern Natural Gas Company. The Appellees were Joseph F. Fritz, G. B. "Boots" Smith Corporation, Challenger Deep Well Services, Inc., H. Lanier B. Foote and Exxon Corporation.

RULE 28.1 LISTING

Sonat Inc.
Citrus Corp.
Sea Robin Pipeline Company
Bear Creek Storage Company
Border Gas, Inc.
Fifth Avenue Realty Company

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MISSISSIPPI

The petitioner, Southern Natural Gas Company, respectfully prays that a writ of certiorari issue to review the judgment and the opinion of the Supreme Court of Mississippi entered in this proceeding.

OPINIONS BELOW

The opinion of the Supreme Court of Mississippi is reported at 523 So. 2d 12 (Miss. 1987). It is reprinted in Appendix A, hereto, App. 1a - 17a, *infra*.

The order of the Supreme Court of Mississippi denying Southern Natural Gas Company's Petition for

Rehearing, dated April 27, 1988, is not officially reported. The order is reprinted in Appendix B, App. 18a, *infra*.

The Final Judgment of the Circuit Court of Marion County, Mississippi, dated November 9, 1984, is not officially reported. The order is reprinted in Appendix C, App. 19a-23a, *infra*.

The order of the Circuit Court of Marion County, Mississippi, granting motion for partial summary judgment, dated July 18, 1984, is not officially reported. The order is reprinted in Appendix D, App. 24a - 28a, *infra*.

The order of the Circuit Court of Marion County, Mississippi, dated March 5, 1984, overruling Southern's Motion to Stay is not officially reported. The order of the Circuit Court of Marion County, Mississippi, dated November 7, 1983, overruling Southern's renewed Motion to Stay is not officially reported. These orders are reprinted in Appendix E, App. 29a - 30a, *infra*.

The Declaratory Order of the Federal Energy Regulatory Commission, dated September 11, 1987, is reported at 40 FERC ¶ 61,225 (1987). It is reprinted in Appendix F, App. 31a - 38a, *infra*.

The order of the Federal Energy Regulatory Commission, dated June 6, 1988, denying rehearing is reported at 43 FERC ¶ 61,454 (1988). It is reprinted in Appendix G, App. 39a - 45a, *infra*.

JURISDICTION

The judgment of the Supreme Court of Mississippi was entered on August 5, 1987. Petitions for re-

hearing were denied on April 27, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

STATUTORY PROVISIONS INVOLVED

18 C.F.R. § 270.207

No portion of the price paid for the first sale of deregulated, high-cost gas, as defined in Section 270.103, or gas for which an application that the gas qualifies as deregulated high-cost gas is pending, may represent consideration for the sale of natural gas which is not deregulated, high-cost gas.

Natural Gas Policy Act § 5049 15 U.S.C. § 3414

(a) General Rule.—It shall be unlawful for any person—

(1) to sell natural gas at a first sale price in excess of any applicable maximum lawful price under this chapter; or

(2) to otherwise violate any provision of this chapter or any rule or order under this chapter.

STATEMENT OF THE CASE

This case comes before the Court in an unusual posture—the Mississippi Supreme Court has ruled that a pricing provision in a gas purchase contract is fully enforceable, thereby requiring Southern Natural Gas Company ("Southern") to pay over three quarters of a million dollars, while the Federal Energy Regula-

tory Commission ("FERC") has determined that this same payment would be illegal under FERC regulations. The FERC's ruling, issued while Petitions for Rehearing were pending before the Mississippi Supreme Court, was nevertheless ignored despite being timely brought to the court's attention. Thus, this appeal involves the important question of whether a state court may ignore a federal agency's interpretation of its own regulation and attempt to establish and enforce a contrary ruling. Simply stated, can a state court require a party to make a payment which is illegal under federal laws?

A. The Gas Contract

The underlying facts are substantially undisputed. The case involves a 1951 gas purchase contract between Southern and Humble Oil & Refining Company (now Exxon) for the purchase of gas produced from the Sandy Hook Field in Marion and Pearl River Counties, Mississippi and Washington Parish, Louisiana (the "contract"). Exxon and Southern subsequently amended this contract numerous times, two of which are relevant herein. On April 4, 1972, the contract was amended (the "1972 Amendment") to provide that the price of gas produced thereunder would bear either a stated price or a price under an "area rate clause",[1] whichever was higher.

After deregulation of certain categories of natural gas in 1978,[2] Exxon sought to again amend the con-

[1] An area rate clause provides that the gas price would be escalated to the price set by the federal government for gas produced from that region. *See generally Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 329 (1983).

[2] *See Natural Gas Policy Act of 1978* ("NGPA"), 15 U.S.C. §§ 3431 *et seq.* (1982).

tract, in part to provide a more advantageous pricing mechanism. Consequently, Exxon and Southern entered into an amendment dated October 5, 1979[3] ("the 1979 Amendment") in partial consideration of the commitment by Exxon to Southern of gas produced from the Mississippi Canyon area in offshore Louisiana. The gas purchased by Southern from Exxon in the Mississippi Canyon area pursuant to this commitment was regulated gas sold at the maximum lawful price.[4]

In return for Exxon's commitment, Southern agreed to amend several provisions of the contract. One provision of the 1979 Amendment was to increase the price payable for gas produced thereunder. The pricing amendment provided for three alternative pricing mechanisms. First, all gas sold under the contract would bear a price of $2.25 per thousand cubic feet. The price escalated by one and one-half percent each calendar quarter. Second, if the FERC allowed higher prices to be paid, then the contract price would increase to that maximum lawful price and thereafter be escalated as provided by the contract. Finally, the amendment added a "favored nations clause," a pricing mechanism applicable to gas which had been price deregulated under the NGPA.[5] The effect of the 1979

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[3] The 1979 amendment reflects that it was not executed by Exxon until December 11, 1979.

[4] The maximum lawful price refers to the highest price allowed by federal law for various categories of regulated gas. The NGPA declares it to be unlawful to sell regulated natural gas at a price in excess of the maximum lawful price. 15 U.S.C. § 3414 (1982).

[5] Favored nations clauses generally set natural gas prices at an amount equal to the highest price(s) being paid to other producers in a certain area. App. 4a, n.1, *infra*. In this case

Amendment was to increase the price payable for deregulated gas. Had the 1979 Amendment not been entered into, the price payable for all deregulated gas produced under the contract would have been a lower price under the 1972 Amendment.

In January, 1980, Exxon began drilling the Sandy Hook Gas Unit 27 Well. Subsequently, Exxon gave up on the well and entered into a farmout agreement with Joseph Fritz, under which Fritz earned an assignment of the underlying leases from Exxon. Exxon retained an overriding royalty interest in production from the well and, upon payout, would have had the option to receive a portion of the working interest. Fritz also assigned certain interests to others, some of whom are parties to this appeal (the Respondents will be generally referred to as "Fritz").[6]

B. The Columbia Case

Prior to the time Southern was to pay Fritz the deregulated price provided under the contract, Southern first became aware of an interpretation of Section 270.207 of FERC regulations by an administrative law judge in *Columbia Gas Transmission Corp.* (hereinafter *"Columbia"*).[7]

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the deregulated pricing provision also included a price lid of 100% of the price of No. 2 fuel oil.

[6] Prior to the eruption of this controversy, Fritz experienced severe financial difficulties and has subsequently declared bankruptcy. As a result, Fritz was forced to assign to his creditors all revenue which he may receive as a result of the instant controversy.

[7] *Columbia Gas Transmission Corp.*, 22 FERC ¶ 63,093 (1982), *aff'd* 26 FERC ¶ 61,034 (1984), *aff'd on rehearing* 26 FERC ¶ 61,334, *on remand*, 28 FERC ¶ 63,005, *settlement approved in* 39 FERC ¶ 61,245 (1987).

On October 24, 1979, the FERC had issued a regulation, now codified at 18 C.F.R. § 270.207, which states:

> No portion of the price paid for the first sale of deregulated natural gas . . . may represent consideration for the sale of natural gas which is not deregulated natural gas.

In *Columbia*, the presiding judge applied Section 270.207 to a contract amendment between Exxon and Columbia which added a favored nations pricing provision in return for Exxon's agreement to commit offshore reserves to Columbia to be sold at the maximum lawful price. Under such a contract, the presiding judge found that payment by Columbia to Exxon of a higher price for deregulated gas constituted a violation of Section 270.207. 22 FERC at 65,351-53.

Subsequently, on January 16, 1984, the FERC itself decided the *Columbia* case on appeal. 26 FERC ¶ 61,034 (1984) ("Order 204"). The FERC confirmed that Section 270.207, "*prohibits* a pipeline from agreeing to pay more for deregulated gas in consideration for the producer's agreement to sell that pipeline additional regulated gas at the ceiling price." *Id.* at 61,122 (emphasis in original).

The parties then petitioned for rehearing before the FERC, asserting numerous grounds for reversal of Order 204. On March 16, 1984, the FERC issued its Order 204-A, affirming the agency's interpretation but remanding the case for determination of the specific volumes of gas which were allegedly overpriced. 26 FERC ¶ 61,334, 61,730 (1984).

On remand, the presiding judge confirmed that the specific regulated reserves listed in the amendment had been sold to Columbia at the maximum lawful price. 28 FERC ¶ 63,005, 65,044-46 (1984). The presiding judge also ascertained the amount of the violation, *id.* at 65,046, and ordered a refund. *Id.* at 65,052. The order of the presiding judge was not appealed. Instead, Exxon and Columbia filed a settlement offer with the FERC which was accepted on June 1, 1987. 39 FERC ¶ 61,245 (1987). Under the terms of the settlement, no violation was admitted. However, Exxon refunded to Columbia and Columbia refunded to its customers an amount calculated to be every penny of the alleged Section 270.207 violation and the parties promised to abide by Section 270.207 in the future. *Id.*

C. Proceedings Subsequent to Columbia

Relevant portions of the initial decision in *Columbia* were first made public on February 28, 1983. Concerned about the implications of the *Columbia* decision, Southern notified Fritz on March 11, 1983, that the payment of a price based upon the 1979 Amendment might be a violation of federal law, but offered that it would be willing to pay the deregulated price into an agreed escrow pending a FERC determination of the application of Section 270.207 in this case. Southern also offered to and has paid to Fritz a price provided under one of the clearly legal alternate pricing provisions of the 1979 Amendment.

Fritz instead filed suit for breach of contract in the Circuit Court of Marion County, Mississippi. Fritz argued that Southern's refusal to pay the full deregulated price pending a FERC determination of its legality constituted an intentional breach of contract

entitling him to actual, consequential and punitive damages. Exxon intervened, seeking declaratory relief that the contract was legal and enforceable. Southern answered, raising the possibility that Section 270.207 could make the demanded payment illegal and asserting that a determination of the issue was within the primary jurisdiction of the FERC.

On June 30, 1983, Southern filed a Petition for Declaratory Order with the FERC seeking that agency's ruling on whether Southern could legally pay to Fritz the deregulated price provided for in the 1979 Amendment. Thereafter, both Exxon and Fritz requested leave to intervene, arguing that Section 270.207 should not be interpreted to prohibit Southern's payment of the full contract price. Additionally, the Georgia Industrial Group, a group of Southern's gas customers, along with Mobil Oil Corporation, Mobil Oil Exploration and Producing Southeast, Inc. and Mobil Producing Texas and New Mexico, Inc. moved to intervene, asserting that Southern's petition raised important questions about the legality of Southern's contract with Fritz and contracts with similar provisions between other parties.[8]

On October 20, 1983 and again on February 27, 1984, Southern moved to stay the state court case on the ground of primary jurisdiction, arguing that the FERC should decide the Section 270.207 issue. On November 7, 1983 and March 5, 1984, the Circuit Court overruled Southern's Motions to Stay the case. On July 18, 1984, the Circuit Court granted Partial Summary Judgment for Fritz, holding principally that

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[8] Neither the FERC nor any of these intervenors participated in the state court proceedings.

Section 270.207, as interpreted in *Columbia*, did not preclude payment of the deregulated price. On November 9, 1984, the Circuit Court entered its Final Judgment awarding Fritz the contract deregulated price, allowing retroactive collection thereof, and awarding attorney's fees and ten percent interest.

Subsequently, Southern appealed the decision of the Circuit Court to the Mississippi Supreme Court. Fritz cross-appealed on damage issues not relevant herein. On August 5, 1987, the Mississippi Supreme Court rendered its decision, affirming the trial court's refusal to stay on primary jurisdiction grounds, based principally upon the FERC's failure to act, and further affirming the trial court's finding that sufficient factual distinctions between the instant case and *Columbia* existed so as to make Section 270.207 inapplicable. The court, however, reversed the trial court's award of other damages to Fritz. The court also affirmed the trial court's refusal to grant punitive damages to Fritz. On August 20, 1987, Southern filed its Petition for Rehearing or, in the Alternative, Motion to Correct Judgment. On August 31, 1987, Fritz filed a Petition for Rehearing.

While the Petitions for Rehearing were pending before the Mississippi Supreme Court, the FERC, on September 11, 1987, entered its decision finding: "The payment by Southern to Fritz of the price provided under the October 5, 1979 contract amendment for deregulated gas would constitute a violation of Section 270.207 of the Commission's regulations." App. 38a, *infra*. The FERC also expressly rejected the distinctions drawn by the Mississippi Supreme Court between this case and *Columbia* stating: "The court found distinctions, which we do not believe warrant

different results, between the instant matter and the Columbia/Exxon case . . . ." App. 34a, n. 11, *infra*.

By letters dated September 18, 1987 and September 22, 1987, Southern provided to the Mississippi Supreme Court a copy of the FERC's opinion and directed the Court to those portions of Southern's brief which argued that the Mississippi Supreme Court should give "controlling weight" to the FERC's ruling. Subsequently, by letter dated September 25, 1987, Fritz argued to the Court that res judicata and jurisdiction principles required that it disregard the decision of the FERC. Southern responded to these arguments on October 6, 1987.

On October 13, 1987, Fritz filed an Application for Rehearing with the FERC, challenging its assumption of jurisdiction and its decision on the merits. Southern also filed an Application for Rehearing as well, but on issues not relevant herein.[9]

On April 27, 1988, the Mississippi Supreme Court overruled both Petitions for Rehearing but corrected the judgment and mandate regarding the rate of interest applicable to the Court's judgment. On June 6, 1988, the FERC issued its Order Denying Rehearing. On June 14, 1988, Fritz filed a Petition for Review of the FERC's Declaratory Order with the United States Court of Appeals for the Fifth Circuit. On July 22, 1988, Southern filed its Petition for Review of the FERC's Declaratory Order based on the same grounds as its Application for Rehearing.

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[9] Southern's application was directed only to that portion of the FERC's Order which attempted to suggest the proper contract price, payable under Mississippi law, in the absence of the illegal pricing provision.

REASONS FOR GRANTING WRIT OF CERTIORARI

1. The Mississippi Supreme Court's Refusal to Defer to FERC's Interpretation of its Own Regulation Prevents a Uniform, Federal Application of Federal Law

Despite having the FERC's ruling in hand before rejecting the Petitions for Rehearing, the Mississippi Supreme Court, without explanation, declined to conform its ruling to that of the FERC. As a result, there are conflicting rulings as to whether performance of this contract would be illegal.[10] The strong national interest in uniform federal interpretation and enforcement of federal law requires that the state court's decision be reviewed and reversed.

Recognizing the necessity of a single, federal decision in this matter, Southern twice moved the trial

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[10] Fritz and Exxon have unsuccessfully asserted that the doctrine of res judicata prevented the FERC from entering a contrary ruling. However, Mississippi law governs the preclusive effect of a Mississippi judgment. *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 523 (1986). Under Mississippi law, both res judicata and collateral estoppel require identity of parties. *Walton v. Bourgeois*, 512 So.2d 698,701 (Miss. 1987); *Weaver v. City of Pascagoula*, No. 51,647 (Miss. May 18, 1988). Since neither the FERC nor the intervenors were parties to the state court proceedings, res judicata is inapplicable.

Fritz and Exxon have also challenged the FERC's jurisdiction to interpret and apply its own regulations to a case involving deregulated gas. The FERC rejected this contention, finding that it does have jurisdiction where deregulated sales are inextricably coupled with sales of regulated gas in a manner which violates statutory maximum lawful price ceilings. *See* App. 41a-42a, *infra*.

Thus the FERC's decision is valid and fully binding on Southern. Consequently, the only question is whether the decision of the FERC or the Mississippi Supreme Court should control.

court to stay on the ground of primary jurisdiction. The court denied both motions. On appeal, Southern again asserted that a stay to await a FERC ruling was appropriate. The Mississippi Supreme Court rejected that assignment of error, stating:

> Entering a stay for the FERC to exercise primary jurisdiction would be the equivalent of sending the case to the graveyard. This Court has no authority to remand the case to the FERC for the exercise of primary jurisdiction.

App. 11a, *infra*.[11]

One of the principal reasons to invoke the doctrine of primary jurisdiction is to assure uniform decisions. *United States v. Western Pacific R.R.*, 352 U.S. 59, 64-65 (1956). However, having assumed decision-making responsibility by rejecting primary jurisdiction, the Mississippi courts were not free to disregard the FERC's interpretation of Section 270.207.

This Court has consistently commanded courts, reaching a decision in one case, to give great deference to a federal agency's interpretation, rendered in another case, of its statutory mandate or own regulations. In *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945), this Court stated:

> Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt . . . . But the ultimate

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[11] However, the FERC, in its Declaratory Order concluded that the issues did fall within its primary jurisdiction. App. 42a, *infra*.

> criterion is the administrative interpretation, which becomes of *controlling weight* unless it is plainly erroneous or inconsistent with the regulation.

Id. at 413-14 (emphasis added).

Further, in *Udall v. Tallman*, 380 U.S. 1 (1965), Justice Warren reiterated: "The [Interior] Secretary's interpretation may not be the only one permitted by the language of the orders, but is quite clearly a reasonable interpretation; courts must therefore respect it." *Id.* at 4.

Other expressions of the deference which courts must give to an agency's interpretation of its own regulation or statutory mandate have ranged from "highest degree persuasive, if not controlling", *United States v. Hammers*, 221 U.S. 220, 225 (1911) to "great deference", *Udall v. Tallman*, 380 U.S. 1, 16 (1965) to "highest respect, and, if acted upon for a number of years, will not be disturbed except for very cogent reasons." *Logan v. Davis*, 233 U.S. 613, 627 (1914).

These statements of the rule, however, arise in instances where the courts are construing agency precedent from an unrelated proceeding. In this case, the Mississippi courts not only had the *Columbia* decision clearly defining the violation but also had the benefit of a FERC interpretation of its own regulation in essentially the same case, involving the same facts, the same issues and certain of the same parties. In addition, the FERC's ruling is on appeal to the Fifth Circuit which will properly decide whether the ruling is erroneous. Under such circumstances, the rights of the Mississippi courts to independently review or dis-

regard FERC's ruling diminishes. In other words, the deference due the FERC's ruling should increase.

The policy considerations which command such high deference by the courts stem from the industry expertise of federal administrative agencies and the need for uniform decision making. *Far East Conference v. United States*, 342 U.S. 570, 574-75 (1952). Thus, the FERC, with its experience and knowledge of the natural gas industry is best situated to interpret the regulation. This is especially true since the regulation was promulgated by the FERC pursuant to its congressionally delegated authority to administer the Natural Gas Policy Act. 15 U.S.C. § 3411(a) (1982). *See Udall v. Tallman*, 380 U.S. 1, 16 (1965). Likewise, it is recognized that a single administrative agency will more uniformly interpret the law than numerous state courts. *Far East Conference*, 342 U.S. at 574-75.

Both the trial court and the Mississippi Supreme Court paid lip service to their responsibility to follow the FERC's interpretation of Section 270.207. For example, both courts, prior to FERC's decision in this case, appeared to recognize *Columbia* as binding precedent. Both courts, however, avoided imposing the same result by finding "distinctions" between this case and *Columbia* which, in their view, permitted a different result.

However, the Mississippi courts' willingness to reach a finding that a producer's contract was illegal is subject to question. For example, the trial court stated: "It is more important to protect the stability of contractual commitments than anticipate the ingenuity of a commission that may be wanting to replace clear legal pronouncements with their own

predilections." App. 28a, *infra*. In its initial decision, the Mississippi Supreme Court stated: "Upon an affirmance of this case, . . . it is extremely likely that Southern will be able to obtain a decision from the FERC on the § 270.207 violation, through the federal system." App. 11a, *infra*. However, when a FERC decision was rendered, mooting the question of "distinctions" between this case and *Columbia*, the Mississippi Supreme Court elected to disregard this order, denying Southern's Petition for Rehearing. The court did not even issue an opinion explaining why it refused to follow FERC's order.

If the instant decision goes unreviewed and unreversed, lack of uniformity will result. On the one hand Fritz contends that the Mississippi decision should bind the FERC, thereby requiring Southern to make payment to Fritz. On the other hand, in *Columbia* and presumably all other similar cases, such payments have been or will be prohibited by FERC as illegal activity. The only way to achieve uniformity of the law would be for the FERC to henceforth adopt the interpretation of Section 270.207 offered by the Mississippi Supreme Court—an unlikely and unsatisfactory solution. Indeed, the resulting lack of uniformity becomes even more unpalatable when one considers that the purpose of Section 270.207 is to avoid circumvention of federal ceiling prices—in other words, to protect gas consumers from unfairly high prices for regulated gas. See Order No. 78, 45 Fed. Reg. 28092 (April 28, 1980).

In this case, we are not faced with a question of importance only to the parties involved, or one which will not arise again. Rather, the issue is the legality of a contracting practice which has been litigated

three times[12] and which, the record reflects, may have been common in the natural gas industry.[13] Because a possible violation of the law is involved, and because the issue may arise again, the need for national uniformity of decisions in accordance with expert agency interpretation is even more acute.

By interpreting its own regulations, the FERC is provided with the opportunity to develop and administer a comprehensive and uniform regulatory plan in accordance with congressional directives. However, if the Mississippi Supreme Court's opinion goes unreviewed, it will be the Mississippi Supreme Court that administers FERC's own regulations without any regard for their uniform construction or purpose. Only through the FERC can we secure the uniform construction of these federal regulations. Otherwise, the natural gas industry may be subjected to as many different interpretations of these federal regulations as there are states.

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[12] In addition to this case and *Columbia*, there is a companion case currently pending in the Circuit Court of Marion County, Mississippi, involving the same contract at issue herein and three of the same parties. *Fritz, Tesoro Petroleum Co. and Exxon Corp. v. Southern Natural Gas Co.*, No. 9965 (Circuit Court of Marion County, Miss. filed Aug. 20, 1984).

[13] The Mobil Oil companies, in intervening in the FERC proceedings, stated that they were "parties to contracts which may have been amended in a substantially similar way as the contract and amendment that is the subject of Southern's Petition for Declaratory Order." Motion of Mobil Oil Corp., *et al.* for Leave to Intervene, *Southern Natural Gas Co.*, No. GP83-35-000. Likewise, an Exxon witness testified in this proceeding that the usual and customary consideration requested by pipelines from Exxon to "upgrade" contracts was the commitment of new gas supplies.

The Mississippi Supreme Court's utter disregard for the FERC's interpretation and administration of its own regulation has resulted in the intolerable conflict of orders from the FERC and the Mississippi Supreme Court. This important conflict between federal administrative power and state judicial power over the interpretation and administration of a federal regulation is deserving of review.

2. Southern Should Not be Faced With Conflicting Orders From the FERC and the Mississippi Supreme Court

The need for uniform decisions made in accordance with agency expertise, while very important from a national perspective as discussed above, is even more acute from Southern's perspective. Simply stated, Southern is "caught between a rock and a hard place."

On one hand, Southern is faced with an order of the Mississippi Supreme Court which, if ultimately enforced, could require it to pay over three quarters of a million dollars to Fritz. Naturally, Mississippi law provides mechanisms to require that Southern make the payment and penalties for its failure to do so. On the other hand, Southern is faced with an order of the FERC that this very same payment would be illegal under FERC regulations. FERC likewise has authority to impose civil and criminal penalties against anyone "who knowingly violates any provisions of [the Natural Gas Policy Act] or any provisions of any rule or order under this Act." 15 U.S.C. § 3414 (1982). In *Columbia*, the FERC recognized that the payment of the contract amendment price may expose the parties to such penalties. 26 FERC at 61,034-35. Absent

a resolution of these conflicting orders by this Court, Southern will be placed in an untenable position.

Southern's plight is made even more difficult by the nature of normal agency oversight and the terms of the gas purchase contract at issue. Under normal circumstances, when a pipeline purchases gas it includes the purchase cost in subsequent purchased gas adjustment filings with the FERC. 15 U.S.C. § 3343 (1982). Through this mechanism, the pipeline seeks FERC's approval to pass through to its customers its entire natural gas acquisition costs. The pipeline's customers, as well as the FERC itself, can object to any cost believed to be improper or illegal.[14] Therefore, FERC may conduct a hearing to determine whether payments to Fritz should be included in the pipeline's resale rates and may either allow or disallow the inclusion. 15 U.S.C. § 3431 (1982). In *Columbia*, this process resulted in a settlement requiring Exxon to refund to Columbia and Columbia refund to its customers the amounts in question. In this case, similar review by FERC will most likely result in an order, binding on Southern, requiring refund of illegal payments.

Furthermore, Article 7, Section 6 of the 1979 Amendment states:

> If the Federal Energy Regulatory Commission . . . should at any time determine by final, non-appealable order that amounts paid by Buyer to Seller . . . are not just and rea-

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[14] As noted above, res judicata is inapplicable to either the FERC or Southern's customers since they were not present in the Mississippi courts. By contrast, all valid orders of the FERC are binding upon Southern.

> sonable, or disallow inclusion in Buyer's resale rates of any amounts paid by Buyer to Seller under this Article 7, then Seller shall refund to Buyer such amounts so paid and disallowed and determined not to be just and reasonable.

Thus, the parties clearly contemplated a refund by Fritz to Southern in the event the FERC disallowed pass through of amounts previously paid by Southern to Fritz. However, since Fritz has no ability to refund any payments made by Southern,[15] this constitutes an illusory remedy.

Additionally, Fritz will undoubtedly seek a ruling that the Mississippi court decision is binding on FERC. However, the decision is not and cannot be binding on FERC. More importantly, to permit such a result would run counter to the public policy requiring great deference to agency precedent. Absent such a requirement, every future litigant who fears an adverse agency decision would be encouraged to circumvent agency review by seeking state court rulings on federal law.

To permit the Mississippi decision to stand will expose Southern to diametrically opposed decisions. Compliance with both is impossible. Moreover, payment pursuant to the Mississippi decision means likely loss of the money without a prospect of refund and possible exposure to FERC imposed civil and criminal penalties for a "knowing" violation of the law. In

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[15] As noted above, Fritz has filed bankruptcy and has assigned to his creditors all proceeds from this well. *See* discussion at n. 6, *infra*. Thus even to make payment pending FERC review would be unworkable since Fritz has no ability to make refund.

such a circumstance, only one decision should control. Because of the national interest in uniform application of the law and because of FERC's unquestioned expertise, the FERC's decision should be the one which controls.

3. The Mississippi Courts Erroneously Interpreted and Applied Federal Law

As noted above, the refusal of the Mississippi Supreme Court to follow FERC's decision raises issues of importance relating to principles of uniform federal agency interpretation of agency regulations as well as issues of importance to Southern. Additionally, the case should be reviewed because the Mississippi Supreme Court's decision was simply wrong.

In promulgating Section 270.207, the FERC was acting pursuant to its statutory duty to protect consumers from unlawfully high gas prices. As the FERC stated: "Section 270.207 interprets the effect of the general prohibition of Section 504 of the NGPA [15 U.S.C. § 3414] against sales of gas at prices in excess of the applicable maximum lawful price and does not impose any prohibition not already implicit in the statute." App. 36a, n. 15, *infra*. In promulgating the regulation, the FERC stated:

> The Commission is concerned that situations may arise where prices paid for deregulated gas may be paid as consideration for the sale of gas subject to price regulation .... [W]e do not intend to prevent circumvention of applicable maximum lawful prices and would consider sales in which part of the price paid for deregulated high cost gas was paid as

> compensation for the sale of price regulated gas to be circumventing applicable maximum lawful prices.

Order No. 78, 45 Fed. Reg. 28092 (April 28, 1980).

Subsequently, when the FERC initially found a violation of Section 270.207 in the *Columbia* case it confirmed that the regulation, "*prohibits* a pipeline from agreeing to pay more for deregulated gas in consideration for the producer's agreement to sell that pipeline additional regulated gas at the ceiling price." 26 FERC at 61,122 (emphasis in original). The FERC further stated:

> [I]n the case where the price of deregulated gas is increased in exchange for new reserves of regulated gas at the ceiling price, the price of the regulated gas exceeds the maximum lawful price because, in consideration for the regulated gas, the producer receives both the ceiling price and additional money for deregulated gas.

Id.

A violation of Section 270.207 requires only three essential facts: first, an agreement to amend a pricing provision applicable to deregulated gas in consideration of the commitment of regulated gas; second, the subsequent production and sale of the regulated gas at the maximum lawful price; and third, the subsequent production and sale of deregulated gas at higher prices under the amendment in question.

In *Columbia*, the FERC applied Section 270.207 to a contract with these three critical facts and found a violation. In this case, all of the same critical facts

would have been present except that Southern, fearing a violation, withheld payment of the deregulated price. Indeed, the FERC called the contract in this case "indistinguishable from the contractual arrangement between Exxon and Columbia." App. 36a, *infra*.

Rather than acknowledge the applicability of Section 270.207 to the instant facts, the Mississippi courts found "distinctions" between this case and *Columbia*. These distinctions relate to the time of execution of the offending amendment, the well's status at the time of contracting relative to the discovery or production of deregulated gas and the type and amount of price increase agreed to. App. 6a - 8a, *infra*.

However, the rule admits none of these distinctions. None of the distinctions raised change the fundamental factors relating to a violation—a contract amendment raising the price applicable to deregulated gas in consideration for the commitment of regulated gas, the subsequent sale of regulated gas at the maximum lawful price, and the operation of the pricing amendment to increase the price payable for deregulated gas.

The Mississippi courts were wrong to find distinctions between this case and the FERC's regulation as interpreted by *Columbia*. The Mississippi courts were further wrong in confirming that no violation existed even after the FERC had expressly rejected all the distinctions raised. Even the Fifth Circuit, on direct appeal from the FERC's decision, is obligated to follow the FERC's decision unless there are compelling indications that it is wrong. *See Red Lion Broadcasting Co. v. Fed. Communications Comm'n*, 395 U.S. 367, 381 (1969). In other words, the Fifth

Circuit cannot reverse a reasonable FERC ruling with which it simply disagrees. The Mississippi Supreme Court owes at least the same degree of deference to the FERC's ruling as the Fifth Circuit owes to such ruling when reviewing it on appeal. Yet the Mississippi court, by denying the Petition for Rehearing without comment, merely disregarded the FERC's decision in this action without giving it any deference. Therefore, the decision of the Mississippi Supreme Court should be reviewed and reversed.

CONCLUSION

For all the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

JOHN M. GROWER
(counsel of record)
R. WILSON MONTJOY II
JOHN E. WADE, JR.
BRUNINI, GRANTHAM, GROWER & HEWES
1400 Trustmark Building
Post Office Drawer 119
Jackson, Mississippi 39205
(601) 948-3101

WILLIAM A. MAJOR, JR.
JOHN C. GRIFFIN
SOUTHERN NATURAL GAS COMPANY
Post Office Box 2563
Birmingham, Alabama 35202-2563
(205) 325-7410

Counsel for Petitioner

July 26, 1988

APPENDIX

APPENDIX A

IN THE SUPREME COURT OF MISSISSIPPI

NO. 56,911

SOUTHERN NATURAL GAS COMPANY

V.

JOSEPH F. FRITZ, G. B. "BOOTS" SMITH CORPORATION, CHALLENGER DEEPWELL SERVICES, INC., H. LANIER B. FOOTE, AND EXXON CORPORATION

FILED AUG. 5, 1987

BEFORE ROY NOBLE LEE, SULLIVAN and GRIFFIN

ROY NOBLE LEE, PRESIDING JUSTICE, FOR THE COURT:

The Circuit Court of Marion County, Mississippi, sitting without a jury, entered judgment in the amount of one million thirty-two thousand four hundred sixty-seven dollars and sixty cents ($1,032,467.60) in favor of Joseph F. Fritz, et al., against Southern Natural Gas Company [Southern] for breach of contract involving the sale of natural gas. Fritz also sought punitive damages, alleging an intentional, willful and bad faith breach, constituting an intentional and tortious breach of contract. The lower court granted summary judgment in favor of Southern Natural Gas Company as to punitive damages. From the money judgment, Southern has appealed, and Fritz, et al., have cross-appealed from the judgment denying the punitive damages claim and from the amount of the money judgment.

Appellant assigns the following errors in the trial below:

I. THE LOWER COURT ERRED IN GRANTING SUMMARY JUDGMENT ON THE RULE 270.207 ISSUE.

II. THE LOWER COURT ERRED IN REFUSING TO STAY THE CASE PENDING REVIEW OF THE RULE 270.207 ISSUE BY THE FEDERAL ENERGY REGULATORY COMMISSION [FERC] PURSUANT TO THE FERC'S PRIMARY JURISDICTION.

III. EVEN IF FRITZ IS ENTITLED TO COLLECT THE DEREGULATED PRICE, HE CANNOT COLLECT IT RETROACTIVELY.

IV. ATTORNEY'S FEES ARE NOT RECOVERABLE WHERE PUNITIVE DAMAGES ARE DISALLOWED.

V. THE LOWER COURT ERRED IN ALLOWING INTEREST CHARGES IN EXCESS OF THE CONTRACT AMOUNT.

Facts

On October 26, 1951, Southern entered into a contract with Humble Oil & Refining Company (now Exxon) for the purchase of gas produced from the Sandy Hook Field in Marion and Pearl River Counties, Mississippi, and Washington Parrish, Louisiana. The contract was amended a number of times by Exxon and Southern, the last being February 5, 1982. The contract amendment involved here was executed October 5, 1979.

Prior to 1978, all gas sold in interstate commerce was subject to federal ceiling price regulation and was referred to as regulated gas. The passage of the Natural Gas Policy Act of 1978 resulted in the lifting of price restrictions on certain categories of natural gas, which was referred to as deregulated gas, while other categories remained reg-

ulated. One of the categories which became deregulated as the result of NCPA was "deep, high-cost" gas produced from a depth of below 15,000 feet. That category applies to the well in the present case.

In early 1978, Exxon had discovered gas in the "Mississippi Canyon" area of off-shore Louisiana and Southern submitted a proposal to purchase the gas from Exxon. During the late summer or fall of 1978, Exxon and Southern reached an agreement in principal to upgrade and modernize various contracts and for Exxon to sell its Mississippi Canyon gas to Southern. The amendments upgrading those contracts were executed by Exxon and Southern October 5, 1979. After the amendment occurred, FERC gave notice that it was considering adopting a regulation governing sales of regulated and deregulated gas. The regulation is 18 C.F.R. § 270.207. The purpose of the regulation was to prevent a producer, who was selling both regulated and deregulated gas to a given purchaser, from evading the price ceilings on regulated gas by hiding part of the price he was receiving for regulated gas in the price he was charging the purchaser for deregulated gas.

In January, 1980, Exxon spudded the Sandy Hook gas Unit 27 #1 (well). Exxon was unable to complete the well as a producer and entered into a farm-out agreement with Fritz. Under its terms, Fritz would earn an assignment of leases from Exxon, if he completed the Sandy Hook well as a productive unit. However, during the drilling operation, the well casing caved and the well cost Fritz an additional five million dollars ($5,000,000), which placed him in dire financial straits. On January 24, 1983, after Fritz completed the well, Exxon executed an assignment to him which was made subject to the Exxon-Southern contract. The agreement stated that Fritz confirm, ratify, and adopt the terms and provisions of the Exxon-Southern contract and assume all rights and obligations of Exxon

thereunder as they related to the interest of Fritz committed to the performance of the contract.

In 1979, Exxon and Southern added a favored nations clause[1] to the contract which had the effect of increasing the price payable for deregulated gas. The amendment was agreed to in consideration of the commitment of regulated gas by Exxon to Southern. That regulated gas was subsequently sold to Southern at the maximum lawful price.

Southern takes the position that because of the interstate nature of the transaction involved here, the parties are preemptively regulated by the FERC; that § 270.207 has been interpreted by the FERC to render illegal the payment of a contract price for natural gas under circumstances similar to the present case; and that penalties probably would be inflicted from a violation of § 270.207. Therefore, Southern declined to pay the full contract price, pending a ruling by the FERC that such payment would not constitute illegal activity.

Fritz, on the other hand, claims that under the facts of the case, there is no violation of § 270.207; that refusal by Southern to pay the contract price amounted to a tortious breach of the contract; and that Fritz is entitled to actual damages, incidental and consequential, and punitive damages.

Law

The record in this case comprises twenty-three (23) volumes, and adds to the complexity of the case. However,

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[1] Favored nations clauses are common in the industry and set the price for natural gas based upon other sales of gas in certain areas. In this case, the favored nations clause set the contract price at the average of the three highest prices being paid under contracts between any pipeline and producer anywhere in Mississippi or southern Louisiana. This provision is qualified to exclude purchases by pipelines from their producer affiliates. It also provides a price limit, stating that the price may never increase above the cost of a certain competing fuel, No. 2 fuel oil.

the issues are relatively simple, except that the two threshold questions relating to the jurisdiction of the FERC are difficult for determination. Southern contends (1) that the lower court erred in granting summary judgment on the § 270.207 issue and (2) that the lower court erred in refusing to stay the case pending review of the § 270.207 issue by the FERC pursuant to the FERC's primary jurisdiction.

The basis of the first two issues is FERC Regulation 270.207, which states:

> Section 270.207 - *Sales of Volumes of Gas Which Include Deregulated High-cost Gas.*
>
> > No portion of the price paid for the first sale of deregulated, high-cost gas, as defined in Section 272.103, or gas for which an application that the gas qualifies as deregulated high-cost gas is pending, may represent consideration for the sale of natural gas which is not deregulated, high-cost gas.

In considering circumvention of maximum lawful prices, the FERC stated its regulatory analysis of the final rule enacting § 270.207:

> The Commission is concerned that situations may arise where prices paid for deregulated gas may be paid as consideration for the sale of gas subject to price regulation. . . . [W]e do not intend to permit circumvention of applicable maximum lawful prices and would consider sales in which part of the price paid for deregulated high cost gas was paid as compensation for the sale of price regulated gas to be circumventing applicable maximum lawful prices.

Order No. 78, 45 Fed. Reg. 28092 (April 28, 1980), FERC Stat. & Reg. ¶ 30,147.

Southern and Fritz both rely upon *Columbia Gas Transmission Corp.*, 22 FERC ¶ 63,093 (1983). In *Columbia*, there was a 1963 contract between Exxon and Columbia for the sale of natural gas produced from the Garden City Field. Subsequently, the parties amended the Garden City contract to include a favored nations clause as a alternate pricing mechanism for deregulated gas. Under the agreement, Exxon was entitled to receive the highest price paid by Columbia to any other producer in the Garden City Field. The favored nations clause operated to increase the price paid for deregulated gas above that which would have been paid without the amendment. As consideration for the amendment, Exxon agreed to commit to Columbia certain gas reserves in off-shore Louisiana, the majority of which was regulated gas. This tie-in between the commitment of regulated gas and a deregulated price increase was held to be the practice prescribed by § 270.207. On January 16, 1984, the FERC decided the *Columbia* case and stated:

> [I]n the case where the price of deregulated gas is increased in exchange for new reserves of regulated gas at the ceiling price, the price of the regulated gas exceeds the maximum lawful price because, in consideration for the regulated gas, the producer receives both the ceiling price and additional money for deregulated gas.

26 FERC ¶ 61,034 (1984), at 61,122.

The FERC held that Columbia and Exxon had violated federal law by paying and receiving a high price under the Garden City contract.

While *Columbia* and the case sub judice are similar, we make a distinction between them.

Columbia:

(1) The 1981 amendment was entered into after § 270.207 was promulgated.

(2) The 1981 amendment provided an alternative pricing formula which increased an existing deregulated price that Columbia Gas was already paying.

(3) At the time of the 1981 amendment, deregulated gas was actually being produced and sold to Columbia Gas under the contract which was amended.

(4) There was no evidence that the increased deregulated price was agreed to as part of a general overall upgrading of all contracts between Exxon and Columbia.

(5) There was no evidence that the increased regulated [sic] price was being paid by Columbia Gas to other producers of deregulated gas.

Southern:

(1) The October 5, 1979, amendment of the Sandy Hook contract and all of the Exxon-Southern contracts were entered into before § 270.207 was even published or promulgated. Exxon and Southern reached agreement to modernize and upgrade many of the provisions existing in nine of their contracts (including but not limited to the price provisions) in the summer of 1978, almost a year and a half before § 270.207 was even published.

(2) The October 5, 1979, amendment of the Sandy Hook contract did not increase an existing deregulated price. Prior to the amendment, no deregulated price was payable under the contract. The amendment in fact provided for the first deregulated price which was payable under the contract.

(3) At the time of the October 5, 1979, amendment of the Sandy Hook contract, no deregulated gas was then being produced from the Sandy Hook Field, no gas was then being produced which was subsequently determined to be deregulated gas, and no wells were even drilling for deregulated gas at Sandy Hook. Further, the Exxon Gas Contracts Department in Houston was not aware of any

deregulated prospects whatsoever in the entire State of Mississippi.

(4) The amendment of all of the existing Exxon-Southern contracts, including the Sandy Hook contract, occurred as part of the usual and customary practice of periodically upgrading and modernizing contract provisions and long term gas contracts.

(5) The deregulated price which was payable under the October 5, 1979, amendment was the same deregulated price which Southern was then paying and offering to other producers of deregulated gas, and, in some cases, was even less than the deregulated price which Southern was paying and offering other producers for deregulated gas.

(6) The deregulated price which was payable under the Sandy Hook amendment was in some cases less than the deregulated price which Exxon was being offered or being paid by other purchasers elsewhere for deregulated gas which Exxon was selling.

Southern concedes that, except for the § 270.207 rule, the contract is binding upon it. We hold that the lower court did not err in finding there was no violation of § 270.207 and in granting the summary judgment.

II.

Southern contends that the lower court erred in refusing to stay the case pending review of the Rule 270.207 issue by the FERC since the FERC had primary jurisdiction; that the disposition of the issue of Rule 270.207 requires the determination of the FERC, a body with special competence; that primary jurisdiction here safeguards the regulatory interest of administrative agencies by insuring uniformity and consistency in the conduct of regulated businesses; that it enables the courts to consider agency views on relevant policy matters and expert agency find-

ings on factual matters; and it allows a more flexible procedure to be utilized in the resolutions of questions that the judicial process may not be adapted to review. *United States v. Western & Pacific Railroad Co.,* 352 U.S. 59, 77 S.Ct. 161, 1 L.Ed.2d 126 (1956); *Far East Conference v. United States,* 342 U.S. 570, 72 S.Ct. 492, 96 L.Ed. 576 (1952).

Simply stated, primary jurisdiction requires that a determination of an agency such as FERC be made first. *Marine Engineers' Beneficial Ass'n v. Interlake Steamship Co.,* 370 U.S. 173 82 S.Ct. 1237, 8 L.Ed.2d 418 (1962). The United States Supreme Court ruled in *Port of Boston Marine Terminal Ass'n v. Rederiaktiebolaget Trans-Atlantic,* 400 U.S. 62, 91 S.Ct. 203, 27 L.Ed.2d 203 (1970):

> [W]hen there is a basis for judicial action, independent of agency proceedings, courts may route the threshold decision as to certain issues to the agency charged with primary responsibility for governmental supervision or control of the particular industry or activity involved.

400 U.S. at 62.

Southern argues that jurisdiction over the parties is concurrent between the Circuit Court of Marion County and the FERC, but that the FERC has primary jurisdiction over the § 270.207 issue because it is a (1) regulation promulgated by the FERC, (2) the FERC is more qualified than the lower court to apply § 270.207 to the facts of this case and to render a decision which is necessary to the ultimate adjudication of the breach of contract question. At pages 16 and 17 of Southern's brief, it states:

> Thus, under *General American,* the Circuit Court clearly should have "stayed its hand" pending the FERC's determination of the unlawfulness of contract performance. Its failure to do so constitutes reversible error.

* * *

> . . . First, by proceeding on the merits, the Circuit Court clearly disregarded the time and effort that could have been saved had the case been stayed. There is presently an action before the FERC to determine whether § 270.207 would be violated in this case. If the Circuit Court had properly awaited the FERC's decision, the expenditure of much time and money would have been saved not only by the litigants, but also by the courts. Because *FERC is not a party to this proceeding, no decision by the Circuit Court will be binding on the FERC.* Should the FERC reach a decision contrary to this Court's, the *parties would be placed in a dilemma, and would be forced to expend considerable effort, judicial time and money to resolve the conflict, all of which would be avoided by the exercise of primary jurisdiction.*

We have carefully considered the briefs and authorities on this question presented by Southern, as well as the response and authorities submitted by Fritz, and we are not persuaded that this cause should be reversed and stayed until the FERC acts.

The record reflects that on June 30, 1983, Southern filed a petition for declaratory order under Rule 207 of the FERC's Rules of Practice & Procedure, requesting a declaration of whether Rule 270.207 prohibits it from paying Fritz and three co-owners a deregulated price for certain natural gas, subject to § 107(c)(1) of the Natural Gas Policy Act of 1978. On January 18, 1984, Southern moved that the FERC expedite consideration of its petition. A proposed order setting the matter for hearing was presented to the FERC and has never been granted or acted upon by the FERC, although four years have expired since the petition was filed. It was also indicated that no other case involving this, or a similar question, has been heard or

acted upon by the FERC. Southern states in its brief that *Columbia* is the only decision relating to the § 270.207 issue. Southern urged that this Court reverse the judgment of the lower court and remand the stay until the FERC acts. At page 20 of its brief, Southern states:

> An exception is for the FERC to make if its policy aims allow one. Therefore, this action should have been stayed to give the FERC that opportunity. *If the FERC agrees with the Plaintiffs' distinctions and excepts this case from § 270.207, the contract price will be paid without further litigation.*

Southern admits it owes the contract price, if there is not a § 270.207 violation and will pay the contract amount without further litigation, if the § 270.207 regulation has not been violated. However, Southern gives no assurance that the FERC will ever act. Entering a stay for the FERC to exercise primary jurisdiction would be the equivalent of sending the case to the graveyard. This Court has no authority to remand the case to the FERC for the exercise of primary jurisdiction. Upon an affirmance of this case, either wholly or partially in favor of Fritz, it is extremely likely that Southern will be able to obtain a decision from the FERC on the § 270.207 violation, through the federal system.

This assignment of error is rejected.

III.

Southern contends that, even if Fritz is entitled to collect the deregulated price, he cannot collect it retroactively.

The deregulated pricing provision in the Exxon-Southern contract by the 1979 amendment states in part:

> If at any time during the term of this agreement the Federal Energy Regulatory Commission

> . . . ceases to have or exercise jurisdiction over the price for all or a part of the gas soid under this agreement, the price to be charged for such deregulated gas *after the cessation date* . . . shall be . . . the average of the three (3) highest prices. . . .

18 C.F.R. § 270.101(c)(2) provides that "the price of gas is deregulated only if a determination by a jurisdictional agency that such gas qualified [as deregulated gas] has become final." Federal law requires that the initial determination of whether gas is deregulated shall be made by the state, here, e.g., the State Oil & Gas Board of Mississippi, 15 U.S.C. 3413(c). The determination by the State Oil & Gas Board is then sent to the FERC and becomes final forty-five (45) days after receipt, if FERC takes no action in the meantime. 18 C.F.R. § 275.202. The State Oil & Gas Board made its initial determination on August 18, 1982, that the well qualified as deregulated gas, but it delayed filing the records with the FERC until December 16, 1982. The gas was not finally determined to be deregulated until forty-five (45) later, January 30, 1983, when the FERC took no action. The FERC did not cease to have or exercise jurisdiction over the gas produced from the well until January 30, 1983, under the terms of the contract. The difference between the NGPA § 102 price which Southern paid and the deregulated contract price from the date of first production in August, 1982, until January 30, 1983, amounts to two hundred eighty thousand dollars ($280,000) retroactive collection.

Numbers of contracts contained a retroactive payment clause for the protection of the producer of deregulated gas. Those clauses were included in contracts to cover a situation such as exists here. However, neither the contract here executed by Exxon and Southern and subsequently ratified and adopted by Fritz, nor any amendment, ever provided for retroactive payments and collections of deregulated gas.

We have carefully considered the briefs and arguments of the parties including those of Fritz relating to oral agreement, waiver, statements and discussions about retroactive payments, and estoppel. The record does not support an amendment of the contract, nor did those positions entitle Fritz to retroactive payments for the period involved.

The lower court found that the Natural Gas Policy Act and FERC regulation § 270.207(c)(2) should be interpreted liberally to protect a producer from such inequities as exist here. Fritz[2] was represented by competent counsel during and after he received, ratified and adopted the contract and amendments thereto. Courts cannot write into a contract that which fails to appear, nor can it interpret a contract liberally just to help one party. This Court must decide questions of law, in accordance with the facts, as best it can.

The judgment of the lower court is reversed and rendered as to allowance of the November and December, 1982, and January, 1983, retroactive payments for deregulated gas.

IV.

Appellant contends that attorney's fees are not recoverable in this case, since punitive damages were disallowed. The lower court allowed Fritz one hundred fifty thousand dollars ($150,000) as attorney's fees, stating that

> Although the contract is silent on attorney's fees and Mississippi common law does not recognize such damages without there being a punitive damage award, this court does feel that a quasi-bad faith change in the course of dealing by one party should not prove to be a detriment to the

[2] He slept on his rights by not seeing that the Oil & Gas Board order was not filed with FERC until four months after its adoption.

other party where there are legal principles which support making the other party whole.

Attorney's fees were not provided for in the contract and they are not recoverable as incidental damages. *Grisham v. Hinton*, 490 So. 2d 1201, 1205-07 (Miss. 1986). In the absence of a statute, attorney's fees are not recoverable unless the facts are of such gross or willful wrong as to justify the infliction of punitive damages. *Aetna Casualty & Surety Co. v. Steele*, 373 So. 2d 797 (1979); *Cooper v. United States Fidelity & Guaranty Co.*, 186 Miss. 116, 188 So. 6 (1939). The finding by the lower court of "quasi bad faith" by Southern is not a proper standard for awarding attorney's fees. *See Fedders Corp. v. Boatright*, 493 So. 2d 301, 311 (Miss. 1986).

The judgment of the lower court is reversed and rendered as to the award of attorney's fees.

V.

Southern complains as error the lower court's action in awarding Fritz ten percent (10%) interest on the amount of the recovery when the contract provided for six percent (6%) interest. The increase in interest by the court was based upon his finding that Fritz could have obtained ten percent (10%) on the money either through the escrow route or other investment procedures. We are of the opinion that the provisions of the contract apply and that only the interest provided in the contract may be recoverable. 22 Am.Jur.2d *Damages* § 179 (1965); 45 Am.Jur.2d *Interest and Usury* § 35 (1969).

The judgment of the lower court is reversed and rendered as to interest recoverable, which is reduced to six percent (6%) per annum.

CROSS-APPEAL

I.

On this cross-appeal, Fritz first assigns as error that the lower court erred in granting summary judgment on

Fritz's claim for punitive damages on the basis of Southern's tortious breach of the gas purchase contract. Fritz emphasizes his claim for punitive damages on an internal memorandum from Southern setting a meeting to review Southern's right to terminate any of its contracts and to unilaterally reduce the price provided in its contracts. The memo seeks a broad legal ground and asks for the best imaginative thoughts of various executive officers. However, a follow-up memo dated March 15, 1983, stated that Southern should continue to pay the higher prices pending the outcome of any litigation. Legal relief was being sought by Southern. Further:

(1) *Columbia Gas Transmission Corp.*, Docket Nos. TA81-1-21-001, et al., 22 FERC ¶ 63,093 (December 30, 1982), was the only case decided involving the question of the FERC's primary jurisdiction at the time and a reasonable interpretation of the case would indicate that the FERC had primary jurisdiction.

(2) *Pennzoil v. FERC*, 645 F.2d 369 (5th Cir. 1981) had been decided, but a reasonable interpretation and argument as to the holding was that the case was dealing only with deregulated gas and not with a contract involving regulated gas and deregulated gas.

(3) On March 31, 1983, Fritz's attorney wrote Southern demanding that it pay the deregulated contract price. The attorney referred generally to Fritz's poor financial situation and inability to pay his creditors. In response, Southern agreed to pay the highest price which was clearly legal and to escrow the difference between the prices. Southern further offered to discuss with Fritz's creditors committee a method of reducing or eliminating any difference in the interest paid to the creditors and interest accruing on the escrow amounts. The offer was rejected by Fritz and suit was filed shortly for the contract breach.

(4) Southern requested the FERC to rule on the issue involved, which it declined to do. The FERC staff stated

that "The language of the contract amendment appears to violate § 270.207" but the FERC declined to adopt its staff's proposed order. It was reasonable for Southern to think that there was a violation of § 270.207.

(5) Southern had reasonable grounds to believe that it was probably in violation of § 270.207 and that severe criminal penalties could be imposed.

This Court is well aware of the principle of law which allows the infliction of punitive damages. Fritz claims that the refusal of Southern to pay the deregulated price for gas was a tortious breach of the contract, which was accompanied by intentional wrong, insult, abuse, or negligence so gross as to constitute an independent tort. *State Farm Fire & Cas. Co. v. Simpson*, 477 So. 2d 242 (Miss. 1985). He cites a number of the recent decisions of this Court involving punitive damages.

We have carefully considered the facts of the case and have again examined our decisions on punitive damages beginning with *Standard Life Ins. Co. v. Veal*. 354 So. 2d 239 (Miss. 1977), and extending through *State Farm Fire & Gas. Co. v. Simpson, supra*, at least sixteen (16) cases, and we are of the opinion that the facts of this case do not justify punitive damages or come within the standard, which will allow submission of the question to a jury. Therefore, we are of the opinion that the lower court did not err in granting a summary judgment for Southern on punitive damages and the assignment of error is rejected.

II.

Fritz contends that the lower court erred in refusing to award him the full amount of his incidental and consequential damages sustained as a result of Southern's breach of contract. As a practical matter, we have answered this question in the direct appeal wherein we denied the loss of attorney's fees and reduced the ten percent (10%) in-

terest rate granted by the lower court to the contract rate of six percent (6%).

Fritz relies upon the provisions of the Uniform Commercial Code, i.e., § 75-2-109(1)(2), for collection of incidental damages as defined under § 75-2-710. He may not recover for consequential damages under the UCC.

> The remedies provided by this code shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the party had fully performed but neither consequential nor special nor penal damages may be had except as specifically provided in this code or by other rule of law.

We are of the opinion that Fritz is not entitled to incidental damages or consequential damages under the Uniform Commercial Code. *Petoleo Brasileiro S. A. Petrobras v. Ameropan Oil Corp.*, 372 F.Supp. 503 (E.D.N.Y. 1974); *Aetna Casualty & Surety Co. v. Day*, 487 So. 2d 830 (Miss. 1986); *S. C. Gray, Inc. v. Ford Motor Co.*, 286 N.W.2d 34 (Mich. 1979); *Brownie's Army & Navy Store, Inc. v. E. J. Burke, Inc.*, 424 N.Y.S.2d 800 (1980). Likewise, we are of the opinion that Fritz is not entitled to such damages under case law of Mississippi. The assigned error is rejected.

The judgment of the lower court is affirmed in part, reversed and rendered in part, and remanded for compilation of interest and entry of judgment consistent with this opinion.

AFFIRMED IN PART; REVERSED AND RENDERED IN PART; AND REMANDED.

WALKER, C.J., HAWKINS, P.J., DAN LEE, PRATHER, ROBERTSON, SULLIVAN, ANDERSON and GRIFFIN, JJ., CONCUR.

APPENDIX B

SUPREME COURT OF MISSISSIPPI
MINUTE BOOK CC

MINUTES MARCH TERM, 1988

WEDNESDAY, APRIL 27, 1988:

SOUTHERN NATURAL GAS COMPANY

#56,911 vs.

JOSEPH F. FRITZ, G. B. "BOOTS" SMITH CORPORATION, CHALLENGER DEEPWELL SERVICES, INC., H. LANIER B. FOOTE AND EXXON CORPORATION

This cause came on to be heard on Southern Natural Gas Company's Petition for Rehearing or, in the Alternative, Motion to Correct Judgement and also on Joseph F. Fritz, et al.'s Petition for Rehearing and Motion to Correct Judgment and this Court having considered both is of the opinion that the same should be denied and same are hereby denied. The judgment and mandate of this Court and corrected as follows: This cause having been submitted on the record from the Circuit Court of Marion County and this Court having considered the same is of the opinion that there is partial error therein and doth order that the Judgment of said Circuit Court rendered in this cause on the 9th day of November, 1984, be and the same is hereby affirmed in part; reversed and rendered in part; and remanded for compilation of interest consistent with opinion of the Court; further, that the part of the judgment affirmed shall draw interest at the rate of six percent (6%) from this date, with no statutory damages computed thereon.

It is further ordered that the appellant and appellee each shall pay one-half (1/2) of all the costs of this appeal to be taxed.

APPENDIX C

IN THE CIRCUIT COURT OF MARION COUNTY MISSISSIPPI

JOSEPH F. FRITZ,
B.B. "BOOTS" SMITH CORPORATION
CHALLENGER INTERNATIONAL SERVICES, INC.,
AND H. LANIER B. FOOTE PLAINTIFFS

VERSUS CIVIL ACTION NO. 9646

SOUTHERN NATURAL GAS COMPANY DEFENDANT

FILED SEPT. 1, 1984

FINAL JUDGMENT

THIS MATTER came before the Court on August 30, 1984 on the question of the amount of damages to be awarded under the summary judgment granted by order dated July 18, 1984, and the Court having considered all matters proffered finds and orders as follows:

I.

That the issue of the amount of damages to be awarded is properly before the Court without a jury by agreement of all the parties.

II.

That this Court granted a summary judgment in favor of the Plaintiffs' position that the natural gas produced under the gas well in question should be given the decontrolled contract price as to the production properly deregulated as deep high cost gas under Section 107(c)(1) of the Natural Gas Policy Act of 1978.

III.

It is undisputed that as of January 30, 1983 the Federal Energy Regulatory Commission (FERC) deregulated all

production from a subsea depth of 15,000 feet or below from the Sandy Hook Gas Unit No. 27. Assuming this Court's ruling of July 18, 1984 is correct, there is no dispute from either party that the price differential between the regulated and deregulated price under the contract in question is $534,384.74, inclusive of taxes on production from February 1983 through July 1984.

IV.

The dispute comes as to the production prior to January 30, 1983. The FERC did not formally receive the State Oil and Gas Board's deregulation order until December 16, 1982 and because of FERC Regulation 275.202, the eligibility determination did not become final for 45 days, giving an eligibility date of January 30th, 1983. However, in this case the Sate Oil and Gas Board failed to forward their order of August 18, 1983 until the second week of December, and it arrived there December 16th. Had the order been sent in August as is the usual procedure the production for November, December and January would have been eligible for the higher price without contest. The gas contract provides on this issue that:

> "If at any time during the term of this agreement the Federal Energy Regulatory Commission . . . ceases to have or exercise jurisdiction over the price for all or a part of the gas sold under this agreement, the price to be charged for such deregulated gas *after the cessation date* . . . shall be. . ."

Southern contends the cessation date is January 30, 1983 and that FERC Regulation 273.204 provides that the only way to get retroactive collection is under a specific contract provision for such and that the above clause clearly prevents retroactive collection.

This Court finds that the Natural Gas Policy Act and FERC Regulation 270.101 (c)(2) should be interpreted lib-

erally to protect a producer from just such inequities as exist here. Gas below 15,000 feet is clearly outside the FERC's pricing jurisdiction initially and the regulations and procedure for removing any doubt relative to its lack of jurisdiction are prefunctory and automatic. For all practical purposes jurisdiction is effectively lost sufficient to comply with the meaning and spirit of the law shortly after the State Oil and Gas Board takes its action. This would clearly allow the November, December and January differential of $72,689.53, $71,645.94 and $108,039.20, respectively, to apply in this case giving a total production increase to $786,759.41.

V.

The next issue is the amount of interest which is appropriate. The contract calls for 6% interest and leaving out the August, 1982 production, the contracted interest would be $58,581.01. The November 1982, December 1982 and January 1983 interest should not be applicable for those three months and therefore the interest should be reduced by $1,153.75 to $57,427.26.

The Plaintiffs want to be reimbursed for interest paid to creditors, but this Court does not find such payments proper as their financial condition is not controllable by Southern and the initial contract is with Exxon, a company which would not be expected to be involved with a creditor's committee. This Court, however, was informed by Southern of its agreement to enter into an escrow arrangement with Plaintiffs to allow these funds to draw interest in excess of the contracted amount. Because of this offer and the unusual nature of this action preventing the Plaintiffs from accepting that offer, and because of the Court holding that the failure to pay the differential is not on a contractual basis but arising from an election by the Defendant to remove the course of dealings of the parties from a straight contractual basis to speculating on favorable long term regulatory confusion to obtain an un-

expected advantage, the Plaintiffs should be made whole in their damages such that they would not be out anything on account of the Defendant unilaterally changing the rules of the game. Therefore this Court finds as a minimum that the Plaintiffs could have obtained 10% interest on the money either through the escrow route or other investment procedures such that the interest should be increased two thirds to a total of $95,708.27.

VI.

On the issue of attorneys fees, the Defendant is the one who has left the confines of the contract to supplant it unilaterally without good cause with a new set of conditions. It cannot then come in and out of the protection of the four corners of the contract at its whim. When it leaves the contract it opens itself to other courses of legal protection of the law available to the other party such as the Uniform Commercial Code and the statutory allowance for attorneys fees on other business relationships such as open accounts. Although the contract is silent on attorneys fees and the Mississippi common law does not recognize such damages without there being a punitive damage award, this Court does feel that a quaisi bad faith change in the course of dealing by one party should not prove to be a detriment to the other party where there are legal principles which support making the other party whole. In this case Plaintiffs have already incurred at least $80,000.00 in attorneys fees and will incur more as the case progresses. This Court finds an award of $150,000.00, which is less than 20% of the original judgment, is proper and in the best interest of justice for attorneys' fees.

THEREFORE, a judgment of $1,032,467.60 is hereby awarded to Plaintiffs against Defendant, together with all costs of this action.

IT IS FURTHER determined by this Court that having been advised of Defendant's desire to appeal that a su-

persedeas appeal will be allowed upon Defendant posting a properly approved appeal bond in the amount of $1,290,584.50 within the time for appeal.

SO ORDERED AND ADJUDGED this the 9th day of November, 1984.

/s/ Michael R. Eubanks
CIRCUIT JUDGE

APPENDIX D

IN THE CIRCUIT COURT OF MARION COUNTY MISSISSIPPI

JOSEPH F. FRITZ, G. B. "BOOTS" SMITH CORP., CHALLENGER DEEPWELL SERVICES, INC. AND H. LANIER B. FOOTE PLAINTIFFS

EXXON CORPORATION INTERVENOR-PLAINTIFF

VERSUS CIVIL CASE NO. 9646

SOUTHERN NATURAL GAS COMPANY DEFENDANT

FILED JULY 19, 1984

ORDER GRANTING MOTION FOR PARTIAL SUMMARY JUDGMENT

This matter came before the Court on Plaintiff's motion for partial summary judgment and the Court having considered all matters presented finds and orders as follows:

This matter was filed by Plaintiff, a natural gas producer, against Defendant, a natural gas pipeline company, for recovery of a contracted price for deregulated gas. Defendant paid and is paying the regulated price and contends that there may be some exposure to Defendant in the event it pays the deregulated price, in view of the *Columbia Gas Transmission Company* decisions of the Federal Energy Regulatory Commission, (FERC) in its opinions 204 and 204-A. That case dealt with an interpretation of 18 C.F.R. § 270.207 saving no portion of the price for deregulated high cost gas may represent consideration for the sale of other gas.

In this case Exxon had a gas contract with Defendant, Southern Natural, for the sale of gas from the Sandy Hook Field in Mississippi dated October 26, 1951. That contract was upgraded on several occasions to the change applicable to the issues in this matter, being a letter agreement dated October 5, 1979 for Southern Natural and accepted De-

cember 11, 1979 by Exxon. Fritz then obtained an assignment of gas rights from Exxon to gas produced from a unit in Sandy Hook Field. Gas was produced and sold through this assignment from the Hosston formation below 15,000 feet, with such gas being deregulated under the Natural Gas Policy Act Section 107(c)(1) covering deep high cost gas.

The question now before the Court is what price is due the producer. Section 4 of heading 2 of the 1979 contract covers the price to be paid for deregulated gas. This is clearly the price due and owing under Mississippi contract law, but Defendant refused to pay it raising the point that this may be a 270.207 violation which could either 1) negate the contract changes of 1979 or 2) subject the price to a reduction for any portion found to be payment for regulated gas. Defendant even has its own application pending before FERC seeking a clarification of 270.207 and *Columbia* as they might apply to the Fritz purchase. Defendant's application, however, has the tenor of wanting to effect the lower price being paid and wanting to justify its arbitrarily reduced payments to Fritz.

The Court finds that the intent of all parties was for the producer to receive the deregulated price. Because this gas is being produced from a depth below 15,000 feet it is no longer subject to the regulation of FERC. At the present time under the present state of law there is no question that the price to be paid Plaintiff is the deregulated price. The Court does acknowledge that there may be a future ruling by the Federal Energy Regulatory Commission which might retroactively affect the prices that have been paid for regulated gas, but the possibility of a price change is insufficient to allow Defendant to withhold actual due and owing contracted prices where there is in effect a clear obligation to pay such price. No legal or equitable reason to withhold the price differential exists even where Plaintiff may be in financial distress and unable to repay these funds and such withholding is arbitrary

and unjustified. This Court further finds that there is no factual connection which would allow Mississippi Canyon gas to be related to the decontrolled gas beneath 15,000 feet and that there were no other interrelationships or considerations which would actually effect the price to be paid for gas produced below this depth under the contracts in question.

The historical facts do not bear out anything more than a modernizing in 1979 of the antiquated contract, antiquated only in the context of the recent extreme changes in natural gas pricing. To get a deregulated price for deregulated gas Exxon may have had to give Southern an incentive and the Mississippi Canyon gas commitment may have been some incentive for Southern, but in point of fact the Mississippi law would not have supported, in this case, a regulated price for deregulated gas, and such incentive or consideration could have been no more than the legal cost to reform the contract. Further, the volume of deregulated gas relative to the volume of regulated gas affected by the contract supports the position that the 270.207 consideration, if any, was miniscule.

The *Columbia* case is distinctive from Fritz in that Fritz is *only* involved in unregulated gas production which would clearly be free of any rebate even if such were to be ordered. *Columbia* or a 270.207 violation cannot be found to apply here for other reasons also. 270.207 was not even effective until *after* the 1979 upgrading of this contract. There was no deep high cost gas being produced under this contract at the time of the contract and this is the only deep high cost gas that was ever produced under the contract. When the Fritz deal was made Exxon had even abandoned its efforts to obtain deep high cost gas from this field. The Exxon and Fritz contracts with Southern were treated by Southern and FERC as two distinct contracts and Fritz only sold deregulated gas and Exxon only sold regulated gas. Exxon has not directly participated in or significantly benefited from the Fritz operation. The

price given for the deregulated gas is standard, the upgrading of the contract is standard and all actions by all parties has been standard for the industry and for complying with all FERC and NPGA requirements. The 1979 contract did not increase any deregulated price and the Mississippi Canyon sale had no direct correlation with the specific provision for Sandy Hook deep, high cost gas.

FERC in *Columbia* clearly said "We (FERC) have no jurisdiction to set the price for such (unregulated) gas." It does have jurisdiction over regulated gas, including to the extent that the regulated price can be surreptitiously increased through deregulated gas pricing. The focus is on the regulated gas price and all corrections in overpricing or penalties thereon must be paid from the regulated sale-not the deregulated sale.

We have now before the Court simply a sale that has no regulations or restrictions on it except for Mississippi contract law.

Fritz produced gas, even if sold under a master contract, is free from any potential price reductions or restrictions other than Section 4 pricing factors. Fritz therefore, would enjoy the fruits of any windfall price scheme relative to regulated gas if such existed. But this Court after a full review of the facts and law in the Exxon - Southern Natural contracts, finds no basis for a regulated gas windfall price scheme.

All parties contracted on a certain basis and Plaintiff's projections, financing and expenditure of funds was founded on a decontrolled price and there is nothing in this record to justify any change in that price. There is no exposure or prejudice to Defendant except in the event that it may not recover any over-payment if there is some subsequent change from a ruling of the Federal Energy Regulatory Commission. This Court finds that if this were to occur that the only recourse then available to Defendant would be from remaining production and not past pro-

duction and then regulated instead of deregulated production. It is more important to protect the stability of contractual commitments than anticipate the ingenuity of a commission that may be wanting to replace clear legal pronouncements with their own predilections.

This Court further finds that payments should be made to Plaintiff on all amounts of production received and on the decontrolled price in effect at the appropriate time, together with legal interest, as damages, on all the unpaid balance until paid. Plaintiff is entitled to a judgment in that amount against Defendant and that a hearing should be held to determine the exact amount for that judgment.

The Court further determines that Defendant is in quasi bad faith for arbitrarily partially withholding funds it was obligated to pay to the point that this Court under its inherent authority to allow attorneys fees in bad faith cases can and should award such fees in this case. In the alternative, that portion of the obligated funds withheld were withheld in such a manner as to constitute an open account obligation under Section 11-53-81 giving this Court authority to award attorneys fees. If this Court cannot by law award attorneys fees, such is bad law and should be changed to afford justice under the facts of this case and such award should be made. Therefore, this Court is awarding attorneys fees in the amount of 25% of the amount to be recovered in the judgment as an additional judgment for Plaintiff against Defendant.

SO ORDERED AND ADJUDGED this the 18th day of July, 1984.

/s/ Michael R. Eubanks
CIRCUIT JUDGE

APPENDIX E

IN THE CIRCUIT COURT OF MARION COUNTY, MISSISSIPPI

JOSEPH F. FRITZ,
G. B. "BOOTS" SMITH CORPORATION,
CHALLENGER DEEPWELL SERVICES, INC., AND
H. LANIER B. FOOTE PLAINTIFFS

EXXON CORPORATION INTERVENOR/PLAINTIFF

vs. NO. 9646

SOUTHERN NATURAL GAS COMPANY DEFENDANT

FILED
MAR 16 1984

ORDER OVERRULING MOTION TO STAY

This day this cause came on for hearing on the Defendant's Motion to Stay, and upon the Court examining the Motion to Stay and the briefs and legal authorities of counsel, the Court is of the opinion that the Motion is not well taken and should be overruled.

IT IS, THEREFORE, ORDERED AND ADJUDGED, that the Defendant's Motion to Stay be and the same is hereby overruled.

This the 5th day of March, 1984.

/s/ Michael R. Eubanks
CIRCUIT JUDGE

IN THE CIRCUIT COURT OF MARION COUNTY, MISSISSIPPI

JOSEPH F. FRITZ,
C. B. "BOOTS" SMITH CORPORATION,
CHALLENGER DEEPWELL SERVICES, INC.,
and H. LANIER B. FOOTE -PLAINTIFFS

VS. CIVIL ACTION NO. 9646

SOUTHERN NATURAL GAS COMPANY DEFENDANT

FILED
NOV. 7, 1983

ORDER OVERULING MOTION TO STAY

This day this cause came on for hearing on the Defendant's Motion to Stay, and upon the Court examining the Motion to Stay and the briefs and legal authorities of counsel, the Court is of the opinion that the Motion is not well taken and should be overuled.

IT IS THEREFORE, ORDERED, AND ADJUDGED that the Defendant's Motion to Stay be and the same is hereby overuled.

This the 7th day of November, A.D., 1983.

/s/ R.I. PRITCHARD, III
CIRCUIT JUDGE

APPENDIX F

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

NATURAL GAS POLICY ACT OF 1978
DECLARATORY ORDER
18 C.F.R. § 270.207

Before Commissioners: Martha O. Hesse, Chairman;
Anthony G. Sousa,
Charles G. Stalon,
Charles A. Trabandt and
C. M. Naeve.

Southern Natural Gas Company — Docket No. GP83-35-000

DECLARATORY ORDER

(Issued September 11, 1987)

On June 30, 1983, Southern Natural Gas Company (Southern) petitioned the Commission for a declaratory order pursuant to Rule 207 of the Commission's Rules of Practice and Procedure.[1] Southern seeks the order to remove uncertainty with regard to section 270.207 of the Commission's regulations.[2] Specifically, Southern requests a declaration of whether section 270.207 prohibits Southern from paying its contract rate to Joseph F. Fritz, G. B. "Boots" Smith Corporation, Challenger International Services, Inc., and H. Lanier B. Foote (collectively referred to as Fritz or the Fritz group) for gas that has qualified under section 107(c)(1) of the Natural Gas Policy Act of 1978 (NGPA). For the reasons set forth below, the Commission finds that Southern is prohibited by section 270.207 of the Commission's regulations from paying Fritz the contract rate.

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[1] 18 C.F.R. § 385.207 (1987).

[2] 18 C.F.R. § 270.207 (1987).

Notice of Southern's petition was published in the *Federal Register*.[3] Timely motions to intervene were filed by Mobil Oil Corporation, Mobil Oil Exploration & Producing Southeast, Inc., Mobil Producing Texas & New Mexico, Inc., The Georgia Industrial Group, Exxon Corporation, and Fritz.[4]

BACKGROUND

On October 26, 1951, Southern entered into a contract with Exxon Corporation's (Exxon's) predecessor in interest, Humble Oil & Refining Company, for the sale of natural gas by Exxon to Southern. The gas is produced from the Sandy Hook Field, Marion and Pearl River Counties, Mississippi, and Washington Parish, Louisiana.

The Exxon/Southern contract was amended on October 5, 1979. In partial consideration for Exxon's dedication of certain OCS gas to Southern, Southern agreed to a new pricing provision. Under the new provision Southern agreed to pay Exxon a rate no lower than the maximum lawful price for the gas. In the event Exxon's gas was determined to be deregulated, Southern agreed to pay Exxon the average of the three highest prices Southern paid its non-affiliated producers for deregulated gas produced in Mississippi and parts of Louisiana. At the time the amendment was entered into, no deregulated gas was being sold from the Sandy Hook Field by Exxon to Southern.

On January 12, 1980, Exxon began drilling operations at the Sandy Hook Gas Unit 27, Well No. 1, on lands covered by the amended contract. Exxon's attempt to find gas was unsuccessful. By assignment dated January 24,

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[3] 48 Fed. Reg. 32,863 (July 19, 1983).

[4] Timely, unopposed motions to intervene are granted by operation of Rule 214 of the Commission's Rules of Practice and Procedure. 18 C.F.R. § 385.214 (1987).

1983,[5] Exxon assigned its interest in Well No. 1 to Joseph F. Fritz. Exxon reserved an overriding royalty interest on the gas produced and sold from the well and the right to exchange such overriding royalty interest for a working interest upon payout. The assignment was made subject to Exxon's contract with Southern for sales from the field in question. Fritz completed the well at a verified depth of 15,374 feet to 15,397 feet, a level from which the Fritz group has successfully produced gas.[6]

On August 18, 1982, Fritz received a "high cost natural gas" well category determination from the State of Mississippi under NGPA section 107(c)(1) (deep well) which became final in January 1983. Fritz entered an adoption and ratification agreement with Southern on February 28, 1983, under which Fritz became a party to the Exxon/Southern contract and the amendments which applied to the sales from the well in question.

POSITION OF THE PARTIES

Southern's request for this declaratory order is precipitated by section 270.207[7] of the Commission's regulations as interpreted by the Commission in its Opinion Nos. 204[8] and 204-A[9]. In those opinions the Commission held, *inter alia,* that Columbia Gas Transmission Corporation (Colum-

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[5] This assignment related back to May 1981 when Fritz took over Exxon's drilling operations on the well in question.

[6] Joseph F. Fritz was joined by G. B. "Boots" Smith Corporation, Challenger International Services, Inc., and H. Lanier B. Foote in the well completion.

[7] 18 C.F.R. § 270.207 (1987) states: "No portion of the price paid for the first sale of deregulated natural gas, as defined in § 272.103, or gas for which an application that the gas gualifies as deregulated natural gas is pending, may represent consideration for the sale of natural gas which is not deregulated gas."

[8] Columbia Gas Transmission Corporation, 26 FERC ¶ 61,034 (1984).

[9] 26 FERC ¶ 61,334 (1984).

bia) and Exxon violated section 270.207 of the Commission's regulations when they amended their gas sales contract to include a favored nations clause for the sale of deregulated gas by Exxon to Columbia as partial consideration for the dedication by Exxon of certain OCS (price regulated) gas to Columbia. The Commission held that "Exxon may have violated the NGPA by charging more than the maximum lawful price and . . . Columbia violated section 270.207 by paying amounts for unregulated gas that were part of the consideration for the sale of regulated gas."[10]

Southern is concerned that paying Fritz the deregulated rate agreed upon in the amendment to the Exxon/Southern contract may be a violation of section 270.207 as interpreted in Opinion Nos. 204 and 204-A. Therefore, Southern has paid Fritz a lower rate for its NGPA section 107(c)(1) gas from the well in question. Southern has, however, offered to put the difference between the amount it is paying Fritz for its gas and the contract rate in escrow until after the Commission issues this declaratory order.

Fritz has filed suit in Mississippi state court and has received a final judgment against Southern in excess of $1 million.[11] Fritz claims that his contract with Southern is separate from Southern's contract with Exxon. Fritz

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[10] *Id.* at 61,729. On June 1, 1987, the Commission issued an order which accepted an uncontested settlement and terminated the Exxon/Columbia proceedings. 39 FERC ¶ 61,245 (1987).

[11] The Mississippi Supreme Court, in Southern Natural Gas Company, v. Joseph F. Fritz *et al.*, Case No. 56,911 (August 5, 1987), upheld the judgment. In doing so, the court found distinctions, which we do not believe warrant different results, between the instant matter and the Columbia/Exxon case referred to above. In rejecting Southern's request to defer consideration of the contractual matter until the Commission could act on the instant petition, the court appeared to contemplate that its decision would make it "extremely likely that Southern will be able to obtain a decision from the FERC on the § 270.207 violation. . . ." Slip Op. 9.

argues that his contract with Southern is a contract solely for the sale of price deregulated gas which has been removed from the Commission's Natural Gas Act jurisdiction by section 601 of the NGPA.[12] Before Fritz acquired his interest in the well, Exxon had expended $7.5 million, while Fritz spent $5 million to complete the well. Fritz states that he entered the agreements with Southern and Exxon in reliance upon receiving the deregulated rate and that he is currently on the verge of bankruptcy because of Southern's refusal to pay the contract rate. Exxon claims that section 270.207 of the Commission's regulations would prohibit payment by Southern to Fritz only if the payment for each unit of deregulated gas to Fritz clearly represented consideration for the sale of a like unit to Exxon. Exxon further argues that since there was no deregulated gas available at the time Southern and Exxon amended their contract, Southern did not intend to pay additional consideration for the sale of regulated gas. Exxon claims that in essence Southern acquired only the right to purchase regulated gas for no more than the maximum lawful price from the newly committed properties.

DISCUSSION

The Commission finds that payment of a deregulated rate by Southern to Fritz pursuant to the October 5, 1979 contract amendment would constitute a violation of section 270.207 of the Commission's regulations. We disagree with the Supreme Court of Mississippi's affirmation of the trial court's finding that no violation of section 270.207 would occur upon payment by Southern of the contract price.[13] To the contrary, the Commission's holding in Opinion No. 204-A makes very clear that a violation of section 270.207 would occur where the parties have "explicitly tied the

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[12] *See* Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

[13] Southern Natural Gas Company v. Fritz, Slip. Op. at 7.

alternative pricing provision for unregulated gas to the commitment of regulated gas."[14]

Although Southern and Fritz are parties to a February 28, 1983 contract solely for the sale of deregulated gas, this contract was based on and adopted the terms of the contract between Exxon and Southern. The inclusion of the favored nations clause in the Exxon/Southern contract was specifically tied to the dedication by Exxon of additional regulated reserves to Southern. This contract is indistinguishable from the contractual arrangement between Exxon and Columbia previously determined by this Commission to violate section 270.207 of the Commission's regulations.[15] Therefore, even though no regulated gas is covered by the Fritz/Southern agreement, which concerns sales of deregulated gas from the Sandy Hook Gas Unit 27, Well No. 1, the payment of the contract price to Fritz would violate the Commission's rules because the payment of the deregulated rate would represent consideration for the dedication by Exxon to Southern of additional jurisdictional reserves.

The tainted nature of this arrangement is unaffected by Exxon's assignment to Fritz of its working interest rights, since Exxon presumably received more for the assignment

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[14] 26 FERC at 61,727.

[15] Section 270.207 interprets the effect of the general prohibition of section 504 of the NGPA against sales of gas at prices in excess of the applicable maximum lawful price and does not impose any prohibition not already implicit in the statute. Thus, the fact that the Exxon/Southern contract was amended to include the favored nations clause prior to promulgation of the regulation would not render lawful the circumvention of the maximum lawful prices for sales of the price-regulated gas dedicated as consideration for inclusion of that clause. In any event, it would be the payment for the deregulated gas at the price provided by the favored nations clause, long after the promulgation of section 270.207, that would constitute a violation of that regulation and not merely the execution of the contract amendment. *See* Opinion No. 204-A, 26 FERC at 61,726.

based on the fact that Southern had agreed to the insertion of the favored rations' clause. The fact that Exxon retained an overriding royalty interest in gas produced from the well, and therefore would profit directly from payment of the contract rate, and Exxon's right to reacquire a working interest in the well upon payout makes it clear that, even with the intervention of Fritz, Exxon stands to gain from the arrangement. This fact is not dispositive, however, in light of our holding that the payment to Fritz of the contract rate would violate the Commission's rules. Fritz, as assignee, stands in Exxon's (the assignor's) shoes. Accordingly, as we find that as payment of the price provided under the favored nations clause to Exxon would violate section 270.207, payment of that price to Fritz likewise would violate section 270.207.

Since the price established under the contract amendment cannot be paid without violating the regulation, the question now arises of what price Southern may lawfully pay Fritz for the gas. Obviously Fritz is entitled to receive compensation for the sale of his gas. We believe Fritz is entitled to receive the price Southern would have agreed to pay for the deregulated gas without receiving Exxon's dedication of additional price-regulated reserves. The Commission believes that such a price should be comparable to those at which deregulated gas in the area has been sold under contracts that do not tie the sales of such gas to sales of price-regulated gas. If, as the Supreme Court of Mississippi indicates in its opinion, Southern and other pipeline purchasers are paying the same price for comparable sales of deregulated gas as under the Exxon/Southern contract amendment, and such comparable sales are under contracts that do not violate section 270.207, Fritz may be entitled to receive nearly as much at comparable market prices as under the unlawful contract provision. The Commission, however, will not undertake to determine what price Fritz may be entitled to without the benefit of the unlawful contract provision. Fritz and Southern may

be able to negotiate an appropriate price, or failing agreement, may resort to courts of competent jurisdiction.

The Commission orders:

The payment by Southern to Fritz of the price provided under the October 5, 1979 contract amendment for deregulated gas would constitute a violation of section 270.207 of the Commission's regulations.

By the Commission.

(S E A L)

/s/ Lois D. Cashell
Lois D. Cashell,
Acting Secretary.

APPENDIX G

43 FERC ¶ 61,454

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Martha O. Hesse, Chairman;
Anthony G. Sousa,
Charles G. Stalon
and Charles A. Trabandt.

Southern Natural Gas Company) Docket Nos. GP83-35-001
) and GP83-35-002

ORDER DENYING REHEARING

(Issued June 6, 1988)

On September 11, 1987, the Commission issued a declaratory order in Docket No. GP83-35-000.[1] The order held that Southern Natural Gas Company (Southern) was prohibited by section 270.207 of the Commission's regulations[2] from paying Joseph F. Fritz, G.B. "Boots" Smith Corporation, Challenger International Services Inc., and H. Lanier B. Foote (Fritz) the contract rate for gas that qualified under section 107(c)(1) of the Natural Gas Policy Act of 1978 (NGPA).[3] The contract at issue was entered into by Southern and Exxon Corporation (Exxon) and was amended on October 5, 1979. Exxon assigned its interest in the subject well to Fritz on January 24, 1983. The assignment was made subject to Exxon's contract with Southern for sales from the field in question. Later Fritz entered into an agreement with Southern which made Fritz a party to the Southern-Exxon contract. On October 13,

[1] 40 FERC ¶ 61,225 (1987).

[2] 18 C.F.R. § 270.207 (1987).

[3] 15 U.S.C. § 3317(c)(1) (1982).

1987, Fritz and Southern requested rehearing of the Commission's September 11, 1987 order.

The 1979 contract amendment provided, in part, that in partial consideration for Exxon's dedication of certain price regulated gas to Southern, Southern would pay the maximum lawful price for the gas from the well. In the event the gas became deregulated, Southern agreed to pay Exxon the average of the three highest prices Southern paid its non-affiliated producers for deregulated gas produced in Mississippi and parts of Louisiana. The Commission held that the amendment explicitly tied the alternative pricing provision to the dedication of additional regulated reserves. This violated section 270.207 of the Commission's regulations[4] which provides that "[n]o portion of the price paid for deregulated natural gas . . . may represent consideration for the sale of natural gas which is not deregulated natural gas." The purpose of this regulation was to prevent circumvention of NGPA ceiling prices.[5] Accordingly, Southern was held to be prohibited from paying Fritz the rate for the gas provided in Fritz's contract with Southern.[6]

In its request Fritz raises the following grounds for rehearing: (1) that the Commission lacks jurisdiction over the subject matter of this proceeding because it involves a contract for the sale of deregulated gas which is removed from Commission jurisdiction by NGPA section 601(a)(1)(B)[7]

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[4] 18 C.F.R. § 270.207 (1988).

[5] *See* Columbia Gas Transmission Corporation, 26 FERC ¶ 61,034 at 61,121-61,124, and 26 FERC ¶ 61,334 at 61,725-61,727 (1984) (*Columbia Gas*).

[6] The Commission also stated that it disagreed with the Supreme Court of Mississippi which upheld a final judgment that Fritz had received in its state court action against Southern. That court found distinctions between this case and *Columbia Gas* which it concluded warranted a different result.

[7] 15 U.S.C. § 3431(a)(1)(B) (1982).

and *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), *cert denied*, 454 U.S. 1124 (1982) (*Pennzoil*); (2) that the order contravenes the Commission's policy of not assuming jurisdiction over a matter which is the subject of a pending state court action; (3) that the final state court judgment against Southern acts as a bar and is entitled to res judicata and collateral estoppel effect; (4) that the Commission's decision is not supported by substantial evidence; and (5) that the Commission has misinterpreted and misapplied section 270.207.

Southern, in its request for rehearing, states that it agrees with the Commission's interpretation of section 270.207. However, Southern requests that the Commission withdraw certain language from the order concerning the price that Fritz is entitled to receive for the gas.[8] Southern states that while the Commission has jurisdiction to prohibit the payment to Fritz of the price under the 1979 amendment, the Commission lacks jurisdiction to render an opinion as to the price Fritz is entitled to receive in the absence of the offending pricing provision.

The Commission finds that Fritz's arguments are without merit. Accordingly we will deny Fritz's request for rehearing. We do not dispute Fritz's assertion that under

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[8] That language is as follows:

> We believe Fritz is entitled to receive the price Southern would have agreed to pay for the deregulated gas without receiving Exxon's dedication of additional price-regulated reserves. The Commission believes that such a price should be comparable to those at which deregulated gas in the area has been sold under contracts that do not tie the sales of such gas to sales of price-regulated gas. If, as the Supreme Court of Mississippi indicates in its opinion, Southern and other pipeline purchasers are paying the same price for comparable sales of deregulated gas as under the Exxon/Southern contract amendment, and such comparable sales are under contracts that do not violate section 270.207, Fritz may be entitled to receive nearly as much at comparable market prices as under the unlawful contract provision. 40 FERC at 61,772.

Pennzoil the Commission does not have jurisdiction to interpret contracts that involve the sale of deregulated gas. However, where the sales of regulated and deregulated gas are inextricably coupled the Commission does have jurisdiction, and can prohibit Southern from making payments to Fritz where those payments would result in the circumvention of the maximum lawful price ceilings of Title I of the NGPA. This is the very purpose for which section 270.207 was promulgated.[9] The contract clause under which Fritz seeks to collect the deregulated rate was an integral part of the Southern/Exxon contract. While Fritz's contract with Southern may cover only deregulated gas, Fritz is a party, by assignment, to the Exxon/Southern contract, a contract that involves gas that remains subject to the Commission's jurisdiction. Further, the pricing provision which Fritz seeks to invoke against Southern resulted from an agreement between Exxon and Southern found to violate the NGPA and the Commission's regulations.

Fritz's assertion that we must defer to the state court's interpretation of our regulations is baseless. Whether there is a violation of section 270.207 of the Commission's regulations clearly falls within the Commission's primary jurisdiction under NGPA section 504 in which Congress granted the Commission jurisdiction to enforce the NGPA Title I pricing provisions. The Commission clearly had primary jurisdiction over the issue of whether the offending contract clause violates either Title I of the NGPA or the regulations promulgated thereunder. Issues relating to whether Title I has been violated are matters which fall within the Commission's primary jurisdiction.

The Commission possesses a special competence to make the determination of whether a contract term results in

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[9] *See* Columbia Gas Transmission Corporation, *supra*, 26 FERC at 61,121.

circumvention of the NGPA Title I prohibitions and purposely promulgated section 270.207 to prevent circumvention. In *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 at 844 (1984), the Court stated that "a court may not substitute its own construction of a statutory provision for a reasonable interpretation by the ... agency" to which Congress has entrusted the administration of that statute. Clearly the Commission is entitled to interpret and apply its own regulations promulgated by the Commission to enforce the provisions of Title I of the NGPA. Further, the Commission's assertion of primary jurisdiction in this matter will also insure that the Commission's regulations are administered uniformly. In *U.S. v. Western Pacific R.R. Co.*, 352 U.S. 59, 63-64 (1956), Court held that the doctrine of primary jurisdiction is invoked:

> Whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views.

We find that in this case the Commission acted properly when it found the offending clause the violate section 270.207 of the Commission's regulations and that the Commission is not bound by the Mississippi court's interpretation of the Commission's own regulations.

Finally, Fritz's claims that the Commission's decision was not based on substantial evidence and that the Commission misapplied section 270.207 of the regulations are likewise without merit. In *Columbia Gas Transmission Corporation*,[10] the Commission found that dedications such as that involved in these proceedings warrant a finding

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[10] *See* note 6, *supra*.

that they violate 270.207. This is especially true where a producer, such as Exxon, potentially stands to benefit from the illegal transaction (in this case, Exxon has retained a right to regain its working interest upon pay-out of the well). Since the Southern/Exxon contract amendment and the assignment to Fritz by Exxon were in the record we find that the Commission had sufficient evidence before it to make its decision.[11]

We next address Southern's request that the Commission strike certain language from the order.[12] Southern states that the Commission lacks authority to instruct the courts of Mississippi as to how they must proceed in determining the price of the gas if the offending clause were deleted from the contract. It was proper for the Commission to address this issue and state its views. As the Commission noted "Fritz is entitled to receive compensation for the sale of his gas."[13] The statement was not intended to instruct the Mississippi courts on how to reconstruct the contract in the absence of the offending language. Rather, the statement was intended as an expression by the Commission of what price it believed Fritz may receive without violating our regulations. Accordingly, we deny Southern's request for rehearing.

The Commission orders:

(A) The requests for rehearing of Fritz, in Docket No. GP83-35-001, and Southern, in Docket No. GP83-35-002, are denied.

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[11] Fritz also states that the Commission has never acted upon Southern's motion to lodge the July 18, 1984 state court decision. While the Commission did not specifically address this motion, the Commission was obviously cognizant of the lower court's decision and that of the Mississippi Supreme Court in the September 11, 1987 order. *See* 40 FERC at 61,771, note 11. We will, however, grant the motion.

[12] *See* note 9, *supra*.

[13] 40 FERC at 61,772.

(B) Southern's motion to lodge is granted.

By the Commission.

(S E A L)

/s/ Lois D. Cashell
Lois D. Cashell,
Acting Secretary.